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Law Department

## UNION PACIFIC RAILROAD COMPANY

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July 22, 1998

**SENT VIA FACSIMILE AND U.S. MAIL**

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Re:    Natural Resource Damage Claim - Coeur d'Alene River Basin  
      **PRIVILEGED SETTLEMENT COMMUNICATION**

Counsel:

Before our next meeting in Denver, it may be useful to briefly review our negotiations to date and identify those issues that remain outstanding. It is also important, given the limitations imposed on our discussions by external events, that we establish a process and schedule to complete our negotiations as quickly as possible.

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Since beginning this process and responding to the government's Natural Resource Damage claim, it has been Union Pacific's intention to reach a global settlement, resolving all claims relating to its historical activities in the Coeur d'Alene basin. At the same time, our proposal was intended to preserve the Wallace Branch right of way as a resource and route for a recreational trail that would be a valuable economic and environmental asset. The Good Faith Offer was made with those objectives and the subsequent amendments and supplements that have been developed in our negotiations have been produced with the idea of responding to the concerns of the Trustees and EPA. Through these efforts, we have reached a point where there appears to be substantial agreement with respect to the elements of trail construction and response activities. The EE/CA and other documents being produced in that process represent a very large amount of work that has been undertaken by Union Pacific, as well as other participants, to provide the framework for a resolution of the issues.

In that context, the Trustees and EPA should recognize that each iteration of the trail design and the resulting response activities have substantially increased both the transaction and potential response costs of this project to Union Pacific. Although Union Pacific has taken issue with the risk analysis used throughout this process, we have endeavored, nonetheless, to address the perceived risk issues raised by the Trustees by preparing and revising action based response plans and providing additional sampling data. As a result, we have reached a point at which there appears to be a sound basis for settlement of the "technical" issues in this matter. What remains to resolve are a number of monetary and legal issues that we have previously discussed and for which differences remain.

We have discussed at some length the issue, which for lack of a better descriptor is termed trail operation and maintenance ("O&M"). In our letter of April 3, 1998, to Curt Fransen, copy to Howard Funke, we outlined an offer for providing a portion of the O&M expense. That offer would provide the trail operator (which we assume to be the Department of Parks and Recreation and the Tribe) with \$2,000,000 to fund the routine operation and maintenance of the trail, including appropriate staffing, for a ten year period after which those obligations would be assumed by the operator. We also indicated that Union Pacific would agree to retain for a period of 20 years responsibility for the pavement surfacing and maintenance of other barrier controls related to human health protection, and to assume for that same period responsibility for major flood damage to the right-of-way.

By letter of May 1, 1998, the State and Tribe responded, indicating that Union Pacific's offer was insufficient to address the maintenance and staffing requirements that they deemed necessary. From a comparison of the stated positions, it appears that a significant gap remains on this issue, largely due to the State's and Tribe's request that a large contingency fund be established. While Union Pacific is prepared to maintain the remedial features of the trail, and fund a ten year period of staffing and maintenance, we

view the State's and Tribe's insistence on a fund for long term staffing and other non-remedial items as unwarranted.

The Trustees' Natural Resource Damage claim is another unresolved area of dispute. Union Pacific, in its Amended Good Faith Offer previously offered payments totaling \$350,000 for projects which would provide natural resource restoration. We have also provided to the Trustees our rationale that the cost construction of the trail, as well as the response activities that will be undertaken, including the removal of ballast within the reservation, constitute a form of compensation and restoration fully recognized by the NRD regulations. Despite this regulatory support of Union Pacific's position, the Trustees have requested a significant cash payment to settle the alleged natural resource damages attributable to Union Pacific's right-of-way and operations.

These two monetary issues represent a significant sum of money, which when added to projected construction costs, greatly exceed Union Pacific's NRD and CERCLA liability. As such, these demands remain serious obstacles to settlement of this case. Resolution of these issues will not be achieved, however, unless there is recognition that Union Pacific's offer consisting of response actions, cash payments and retention of maintenance obligation is both significant and unique. Viewed in the context of the litigation risk, Union Pacific clearly stands as a *de minimis* party that has made a major settlement offer and has carried the major burden of producing the reports and documents that have identified and framed the issues for negotiation. Union Pacific also stands alone among the defendants in the litigation in attempting to resolve issues with the Trustees and EPA.

As it has done with the technical issues, Union Pacific is prepared to respond to the O&M and NRD issues with substantive proposals at our next meeting. We can only do so, however, if it is clear that all of the material issues that have been raised in our discussions are resolved in principle. From Union Pacific's perspective, it is important that this process and the Consent Decree that is generated results in a full and complete release for all historical rail operations that have occurred in the basin. We would expect that the release include all Natural Resource Damage claims, as well as claims under CERCLA. We recognize that issues remain with respect to operations in Canyon Creek and the Wallace rail yard, and Union Pacific is prepared to address those items specifically.

It is also critical that Union Pacific have access to the Central Impoundment Area for two construction seasons beginning in 1999. While we would hope to conduct the bulk of removals during the 1999 construction season, due to any number of factors that may not be possible and some removals may need to occur in 2000. We need the Trustees' and EPA's commitment that some portion of the CIA will be available for this period for the completion of our work.

Union Pacific's offer addresses NRD claims and response actions for its entire right-of-way, including the right-of-way between Mullan and Wallace. In addition, Union Pacific may be required to undertake response actions in Canyon Creek and the Wallace Yard. The Wallace-Mullan line, as well as a parallel line from Wallace to Burke and the Wallace Yard were all constructed and operated by Northern Pacific and subsequently Burlington Northern Railroad for decades. Although Burlington Northern Santa Fe has been identified as a potential defendant, it is our understanding that neither the Trustees nor EPA has made demands or begun discussions with BNSF. Union Pacific should not be required to pay for BNSF's share of liability. We believe that the equitable way to address this liability question is by assigning the Trustees rights against BNSF to Union Pacific. Alternatively, the Trustees should eliminate their claims against UP for Natural Resource Damages and EPA should address its enforcement of response actions for Canyon Creek and Wallace Yard to BNSF.

If we can come to some resolution on these issues, there are a large number of items that will come up for discussion in connection with a Consent Decree. Among others, we need to identify and resolve any claims for past response or future oversight costs. We also need to discuss and agree on a procedure for addressing the conditions imposed by the Surface Transportation Board and the necessity for obtaining a Certificate of Interim Trail Use for the right-of-way. In that regard, we have had some preliminary discussions with counsel for STB and have some ideas about a process which would address these issues and enable the Board to meet its obligations and issue a Certificate of Interim Trail Use within a relatively short period of time.

Union Pacific will be prepared for the August 4 meeting to discuss and resolve the remaining substantive issues. It is important that counsel for the Trustees and EPA likewise be prepared with settlement authority so that decisions can be made on these issues.

In short, Union Pacific remains committed to this process and is prepared to affirmatively address the remaining issues. If the Trustees are similarly prepared to negotiate these issues in good faith, we remain confident that settlement can be achieved.

Very truly yours,



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